Internal Revenue Service

memorandum

CC:TL:Br3
DJWiles

date: AUG 31 1988

to: Deputy Regional Counsel (TL) CC:W
Western Region

from: Director, Tax Litigation Division CC:TL

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subject: Applicability of § 6661 Penalties to Nonfilers

This memorandum is in response to your memorandum (CC:SAC:TL-N-8200-88) with respect to the critical nature of coordination of Counsel's position after Woods v. Commissioner, 91 T.C. No. 11 (1988) with the Examination function. We totally agree with your comments that time is of the essence, and that counsel's position must be consistent with that of our client, in this case Examination, Collection, and Appeals. We have been in the process of pursuing that coordination, and we have reason to believe that all affected functions will shortly fall into line in agreement with Tax Litigation's decision to follow the Woods opinion.

At the date of this writing, the June 9, 1988 memorandum of the Assistant Commissioner (Examination) suspending the assertion of the § 6661 penalty is still in effect. However, a short time after the issuance of that memorandum, representatives of this Division instituted discussions with Examination to modify that policy and to lift the suspension while allowing consideration of prepayment credits. We also met with Collection which had adopted a similar policy to that of Examination. As you might imagine, one obstacle to a change in policy was the existence of Treas. Reg. § 1.6661-2(a) which would not appear to allow consideration of prepayment credits. Consideration was given to modifying Treas. Reg. § 1.6661-2(a) and (d) to allow for a change in this policy. Nevertheless, Examination and Collection had informally agreed to permanently modify its calculation of the § 6661 penalty as applied to nonfilers and to lift the June 9, 1988 suspension and were circulating the formalization of this position at the time of the Woods opinion, July 25, 1988.

Shortly after the Woods opinion, this office, with concurrence of the Deputy Chief Counsel, determined to follow the opinion of the Tax Court. This was announced to all districts by CATS message of August 1, 1988. Interestingly, the partial invalidation of Treas. Reg. § 1.6661-2(a) by Woods removed any legal obstacles to the policy change which had been under consideration prior to that time.

We have renewed our coordination efforts since Woods and are assured by representatives of Examination that the June 9, 1988 memorandum will shortly be replaced by another adopting in full the litigation position we have announced. We, and the Assistant Commissioner, do realize the need for a final expeditious decision and announcement in this regard. At the same time, the calculation ramifications of this change in position are being explored with Examination and Appeals, since the appropriate calculation is not always self-evident. We are confident of agreement shortly.

In the meantime, Counsel are instructed to follow Woods in all aspects. An A.O.D. has been approved by this Division and is under normal review by others. We have also issued a Notice "Underpayments For Application of the Section 6661 Penalty" bearing a date of August 15, 1988 which sets forth directions to bring our litigation policies in line with Woods. (An advance copy of this Notice is attached). Finally, we will issue shortly an LGM bearing a date of August 10, 1988 which provides more detail, including calculation examples (a draft of this is also attached). A combination of these documents should resolve most litigation issues that will arise. Since Examination will likely issue guidance consistent therewith in the near future, the problems you discuss should evaporate.

To the extent that Examination has not asserted the penalty because of the suspension policy, counsel is free to raise the issue as it would any new issue in a case it receives. Thus in pre-issuance review of notices of deficiency, counsel should be free to recommend the assertion of the penalty consistent with our litigation position. Likewise, it may be raised in docketed cases, recalling of course that respondent will bear the burden of proof as to that issue. I.R.C. § 6214(a). See also C.C.D.M. (35)4(21)(10) and (35)425. It is expected that judgment will be exercised so that the raising of the penalty issue will not be used to force settlement of other substantive issues or to overbear petitioners. And, in the instance you cite where the penalty had been once asserted and later removed pursuant to the June 9, 1988 memo, it would also seem inappropriate to raise the issue again in that case. We leave to your discretion and sound judgment when to raise the penalty issue when it has not been raised in the notice of deficiency.

We do not believe that the fact that since taxpayers may temporarily be treated inconsistently under this policy raises any issue of attorneys fees previously raised by Phillips v. Commissioner, 88 T.C. 529 (1987), rev'd on this issue ___ F.2d ___, 88-2 U.S.T.C. para. 9431 (D.C. Cir. 1988). The Tax Court's holding in that case was premised upon an inconsistency between public technical advice (revenue rulings) and litigation position. The court held that it was unreasonable to litigate contrary to our published technical rulings. Even if this holding had not been reversed on appeal, it would still not cause concern here since the present case is vastly different. The Commissioner's published technical and litigation positions prior to Woods was totally consistent in that both held that the § 6661 penalty applied to nonfilers (an issue with which the Tax Court agreed) without regard to prepayment credits upon reliance of the Treasury regulation. Hereafter, both technical and litigation positions will also be consistent, i.e., we will follow the holding in Woods. The June 9 memo established no technical position contrary to this, or any technical position at all. Rather, it merely "suspended" the application of the penalty in certain programs pending review and recommendations of the Commissioner's Penalty Study Group. In other words, administratively the Assistant Commissioner determined that the policy needed to be reconsidered. No public, technical, or legal determination of any kind was made. While there are surely lessons to be learned from Phillips, those lessons do not impact here.

The Tax Court has faced on numerous occasions the situation where respondent pressed only a 10 percent rate under § 6661 which is a situation analogous to the nonassertion policy of June 9. While acknowledging the legal rate to be 25 percent, the Court has consistently awarded the 10 percent rate where that was the only assertion by respondent. See e.g. Horn v. Commissioner, 90 T.C. 908 (1988); Parchutz v. Commissioner, T.C. Memo. 1988-327; and Rodriguez v. Commissioner, T.C. Memo. 1988-192. In the meantime, it has had no problem in upholding the 25 percent rate where respondent has properly raised that issue. See e.g. Woods; Williams v. Commissioner, T.C. Memo. 1988-368; Looney v. Commissioner, T.C. Memo. 1988-332; Silkman v. Commissioner, T.C. Memo. 1988-291. The Court does not review our administrative determinations not to assert taxes or penalties where applicable. And where we do so assert, it is of no moment that similar penalties have not been asserted in similar cases.

CONCLUSION

We expect the inconsistency in treatment between Examination and Counsel to be resolved shortly, with Examination lifting its suspension of the issue and thereafter asserting the penalty consistent with Woods. We will obviously notify all offices if there is a delay or change in this indicated direction. In the meantime, consistent with the A.O.D. and Notice as to Woods, counsel should assert the penalty in appropriate cases even where Examination has not.

We would appreciate your view of the positions established in the LGM and would gratefully receive any comments or questions it engenders. Please call Branch Chief Daniel J. Wiles at 566-3335 in this regard.

MARLENE GROSS

By: _____
DANIEL J. WILES
Chief, Branch No. 3
Tax Litigation Division

Enclosures:
Advance Notice
Advance LGM